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IN THE

Supreme Court of the United States

October Term, 1939.

No. 34.

ESTATE OF CHARLES HENRY SANFORD, Deceased, Jennie R. Baird, Substitutionary Administratrix, c. t. a.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE PETITIONER.

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THE COURT-PRESS, N. Y. C.

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Opinions Below and Jurisdiction.

The opinion of the Circuit Court of Appeals for the Third Circuit is reported in 103 F. (2d) 81, and appears at R. 173; the opinion of the Board of Tax Appeals is unreported but appears at R. 33.

The judgment of the Circuit Court of Appeals was entered on March 25, 1939 (R. 178). A petition for certiorari was filed on April 17, 1939, and was granted May 15, 1939 (R. 178). The jurisdiction of this Court arises under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Statement of the Case.

The case involves an asserted deficiency in Federal gift taxes for 1924 amounting to $1,000,745, and arises

under the gift tax provisions of the Revenue Act of 1924 (Part II of Title III, Sections 319-324). The Board of Tax Appeals sustained the deficiency asserted by the Commissioner of Internal Revenue, and the Circuit Court of Appeals upheld the Board.

Sanford, the decedent, died in 1928, a resident of New Jersey. In 1913, Sanford created certain trusts, reserving full powers of revocation and modification. In 1919, some five years prior to the passage of the first Federal Gift Tax Act, Sanford surrendered the power of revocation, reserving only the right to modify the trusts, which right expressly excluded any right or privilege to revest in himself the principal or income of the trusts. In 1924 Sanford surrendered the reserved right to modify. The value of the corpus of the trusts at that time was $6,846,225.

The Board of Tax Appeals and the Circuit Court of Appeals held that a taxable transfer did not occur until 1924, when the limited right of modification was terminated, and sustained a deficiency computed upon the full value of the corpus of $6,846,225.

On May 22, 1939, this Court granted the petition of the Government for certiorari in the case of *Rasquin, Collector* v. *Humphreys*, No. 37, October Term, 1939, decided by the Circuit Court of Appeals for the Second Circuit; and in the same order the *Humphreys* case was set down for argument directly following the *Sanford* case. The position of the Government in the *Humphreys* case is squarely in conflict with its position in this case, which it frankly admitted in its memorandum of non-opposition filed in response to our petition for certiorari.

The Question Presented.

The single question here involved is whether a gift made in trust is subject to the Federal gift tax in the year the settlor irrevocably relinquishes the power to revest in himself the income or corpus of the trust, reserving a power to modify in other respects (such as the power to change beneficiaries), or in a later year when the remaining power to modify is surrendered, the trust concededly being a valid and enforceable trust and not failing for the lack of a donee.

The Statutes and Regulations Involved.

The statutes and the regulations involved are set forth in an Appendix, *infra,* pages 63-65.

Statement of the Facts.

The case was tried upon the petition and answer, and one main and two supplemental stipulations of fact (R. 10, 12, 32), with exhibits attached. There was no oral testimony. The Board adopted the facts as stipulated "for all purposes of this proceeding" (R. 33). The facts, therefore, are not in dispute.

On December 24, 1913, Charles Henry Sanford by a single trust indenture created certain trusts, naming Guaranty Trust Company of New York as Trustee, and on that date and at various times prior to 1924 transferred certain property to the Trustee (R. 11). Originally there were six trusts, a trust for Colville H. S. Barclay, a great grandchild, and five trusts for five grandchildren. Two of these five died without issue, terminating their trusts, and on such deaths the settlor added the corpus of these

trusts to the trusts for the remaining grandchildren (R. 65-67, 99-100). This left four trusts in existence on August 21, 1924 (R. 100, 162).† The named beneficiaries of these four trusts were alive and in being on that date (R. 12). Under the provisions of the trust indenture, the Trustee was directed to collect the income and profits and to distribute the income and ultimately the principal among the named beneficiaries (R. 47-51).

The trust indenture of December 24, 1913, contained, among others, the following provision (R. 52):

> "The party of the first part [Sanford], however, reserves the right to terminate or modify any or all of the trusts herein created by a suitable instrument in writing executed under his hand and seal and duly acknowledged as a deed of real estate is required to be acknowledged under the laws of the State of New York and filed with the party of the second part [Guaranty Trust Company of New York]."

Under the reserved power, Sanford from time to time executed certain supplemental trust indentures amending the provisions of the trusts. Of these, only two are material, the indenture dated November 26, 1919 (R. 90), and the indenture dated August 21, 1924 (R. 162).

By the supplemental indenture of November 26, 1919, Sanford surrendered the power to revest in himself all or any part of the income or corpus of the trusts, reserving only a power to modify the trusts in other respects, such as, for example, the

† These trusts were known as the "Sarita E. Barclay Trust", the "Frances G. Phipps Trust", the "Herbert S. Ward Trust" and the "Colville H. S. Barclay Trust" (R. 162; Notice of Deficiency, R. 8).

power to change beneficiaries. Thus the indenture of November 26, 1919, after reciting the powers reserved in the original indenture quoted above and the desire of the settlor to modify such "above-quoted provision", provided (R. 91):

> "Now, therefore, the party of the first part does hereby modify the same so that the said clause shall read as follows:
>
> > 'The party of the first part, however, reserves the right to modify any or all of the trusts herein created by suitable instruments in writing executed under his hand and seal and duly acknowledged as a deed of real estate is required to be acknowledged under the laws of the State of New York, and filed with the party of the second part; but this right of modification, however, shall in no way be deemed or construed to include any right or privilege in the party of the first part to withdraw principal or income from any trust created by this instrument.' "

Sanford's powers in respect of the trusts lay in this condition for some five years. On August 21, 1924, by a supplemental indenture executed on that date, Sanford surrendered and renounced all the remaining powers over the trusts. Thus the indenture of August 21, 1924, after reciting certain paragraphs of the trust indenture as amended, including the above quoted paragraph in the indenture of November 26, 1919, provided that such recited paragraphs (R. 169, 171)—

> "are hereby revoked and in their place and stead the following terms shall apply and govern as to each and every trust created hereunder, to wit:
>
> * * * * * * *
>
> "7. The party of the first part hereby renounces all rights to further modify the terms

of the said trusts or any of them and does hereby surrender all such rights reserved to him by the indenture of December 24th, 1913, and by the various indentures supplemental thereto."

The Filing of a Gift Tax Return and the History of the Case in the Treasury Department.

Sanford did not file a gift tax return for the year 1924 (R. 11). He died December 22, 1928, a resident of Monmouth County, New Jersey.† Joseph McDermott was duly appointed and acted as administrator c.t.a. until his death on June 10, 1938 (R. 10, 11).††

In the early fall of 1934, a revenue agent in an interview with McDermott raised the question as to whether Sanford's surrender on August 21, 1924, of all further right to modify the terms of the trusts constituted a taxable transfer of the corpus of the trusts. Following this interview, McDermott prepared and filed a gift tax return on behalf of the Sanford Estate with the Collector of Internal Revenue for the District of New Jersey in Newark (R. 11, 12), listing the property comprising the corpus of the trusts on August 21, 1924, but disclaiming any liability for a gift tax (R. 11).

On the audit of this return a hearing was had in Washington in October, 1934, before the Miscellane-

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† The gifts accomplished by the creation of these trusts were not gifts in contemplation of death. The question of the inclusion of the corpus of the trusts was raised by the Bureau in auditing Sanford's estate tax return, a case was made and after full consideration the Bureau ruled that the corpus of these trusts was not includible as part of the gross estate (R. 43).

†† Joseph McDermott died on June 10, 1938; on August 23, 1938, Jennie R. Baird was duly appointed to succeed him; and by order of the Circuit Court of Appeals dated September 2, 1938, Jennie R. Baird as Substitutionary Administratrix c. t. a. was substituted in these proceedings.

ous Tax Unit, at which counsel for the estate appeared. A memorandum of law was filed on its behalf and the question was fully argued and considered (R. 12). Thereafter the question was referred to the Assistant General Counsel for the Bureau of Internal Revenue (the officer now known as the Chief Counsel for the Bureau).

In February, 1935, responsive to a letter from the Under Secretary of the Treasury inquiring about the *Sanford* case, the Assistant General Counsel issued a memorandum addressed to the Under Secretary (unpublished), known as G. C. M. 14497, expressing the opinion that the gift was not "effective and absolute" until August 21, 1924, when the power of modification was surrendered, adding, however, that the ruling was tentative only and should be considered as "subject to change" on the production of additional evidence justifying a different conclusion. The memorandum set forth the statute, the facts and a discussion of some court decisions, but it neither referred to nor considered the pertinent regulations of the Commissioner of Internal Revenue issued under the Gift Tax Act of 1924. The memorandum was signed "Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue" over the initials "A. H. K.", referring to Arthur H. Kent, at that time Assistant to the Assistant General Counsel (R. 13, 21).

Some two months later, in March, 1935, a formal hearing in the case was held before the Assistant General Counsel. There were present at this hearing counsel for the estate and some ten or twelve representatives of the Assistant General Counsel's office and of the Miscellaneous Tax Unit, including Mr. Kent acting for the Assistant General Counsel (R. 12). At this hearing the question was again

fully argued and considered (R. 12). Following this hearing, the Assistant General Counsel promulgated a second ruling dated April 8, 1935 (also unpublished), known as G. C. M. 14774, which was delivered to Deputy Commissioner Bliss in charge of the Miscellaneous Tax Unit. As in the earlier tentative ruling, G. C. M. 14774 set forth the statute, the facts and a discussion of the authorities, but, unlike the earlier ruling, Article 1 of Regulations 67 (the regulations promulgated under the Gift Tax Act of 1924), and Article 3 of Regulations 79 (the first regulations promulgated under the Gift Tax Act of 1932), were set forth in full and considered. After quoting these Regulations, the ruling concluded as follows (R. 21):

> "* * * upon a careful consideration of [the arguments advanced] this office is convinced that the Department must adhere to the position that in all such cases the relinquishment or cancellation by the settlor of his right to revest title to the trust property in himself constitutes the gift of the property for gift tax purposes. If the consummation of the gift by vesting title to the property in the donee were to be adopted as the criterion of taxability any such rule would not only be in conflict with the court decisions and regulations cited but, it seems certain, would also lead to many difficulties of an administrative character and otherwise. So far as Sanford was concerned the gift was complete on the date when he relinquished the right to terminate the trusts.
>
> "For the reasons indicated it is the opinion of this office that the gift in the instant case became effective on November 26, 1919, when the said Sanford relinquished his right to terminate the trusts in question and that as this transaction occurred before the gift tax law became effective it is not subject to said tax."

This ruling of April 8, 1935, was signed as before "Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue", with the initials "A.H.K." below, again referring to Arthur H. Kent, who was acting for Mr. Jackson in his absence (R. 21).

Under the same date, namely, April 8, 1935, Mr. Kent addressed a memorandum to Mr. Herman Oliphant, the General Counsel for the Treasury Department (R. 28), sending Mr. Oliphant two copies of the ruling of April 8, 1935, one for himself and one for transmission to the Under Secretary of the Treasury. The concluding paragraph of Mr. Kent's memorandum was as follows:

> "I have given the case careful personal attention and sat in on the conference with the attorneys for the trustee and the estate. I am now convinced that the position tentatively taken in the prior opinion should not be maintained, and that its possible prejudicial results upon the revenues both from gift tax and income tax far outweigh the considerable revenue we would gain from asserting a gift tax liability against this trust. Even though we won in the courts, which seems unlikely under the present statutes and regulations, our victory would be a Pyrrhic one."

The Under Secretary of the Treasury, after discussing the ruling with counsel for the Treasury and assuring himself that it had been made with careful consideration of the law, approved the ruling (R. 32, 33).

On April 19, 1935, Sanford's administrator received a letter signed by Deputy Commissioner Bliss, which, after reciting that the gift tax return filed on behalf of the estate had been examined, concluded (R. 29):

> "The examination discloses no gift tax lia-

bility. Accordingly, the case has been marked closed in so far as the Federal gift tax is concerned."

The Decision in Hesslein v. Hoey.

The case remained closed for some two and a half years. On July 26, 1937, the Circuit Court of Appeals for the Second Circuit handed down its decision in *Hesslein* v. *Hoey*, 91 F. (2d) 954. The case involved a trust created in 1934, under the terms of which the settlor reserved a power to alter the trust but not in any manner beneficial to himself or his estate. In conformity with the Treasury's final ruling in the *Sanford* case, the Government contended that in the case of a gift in trust the gift tax attached at the point when the settlor surrendered the power to revest in himself income or principal, which in the *Hesslein* case occurred on the creation of the trust. The Circuit Court of Appeals for the Second Circuit nevertheless decided against the Government and sustained the taxpayer, Judge Swan writing for himself and Judge Manton; Judge Augustus N. Hand dissenting with a written opinion.

Following the decision in the *Hesslein* case, the *Sanford* case was reopened. In an unpublished memorandum (R. 29) dated October 14, 1937, known as G. C. M. 19260, the Chief Counsel of the Bureau,† after reviewing the facts in the second *Sanford* ruling (G. C. M. 14774) and reciting that "G. C. M. 14774 gives full effect to the [Commissioner's] regulations", said that inasmuch as the opinion in the *Hesslein* case was contrary to the Commissioner's Regulations issued

† Between April 8, 1935, when G. C. M. 14774 was promulgated, and October 14, 1937, the title of the chief law officer of the Bureau was changed to "Chief Counsel of the Bureau of Internal Revenue".

under the 1932 Act he had recommended that a petition for certiorari be filed, but since the outcome of such proceedings was still uncertain he advised the issuance of a ninety-day letter, adding that "G. C. M. 14774 is hereby revoked".

The final deficiency letter in this case was issued and delivered to the Sanford Estate a day or two before the running of the statute of limitations.

The Government applied to this Court for a writ of certiorari in the *Hesslein* case, but the application was denied (302 U. S. 756).

Article 1 of Regulations 67 (1924 Edition), the Regulations which underlay the second *Sanford* ruling, has not been changed, but remains in effect, unaltered, today, and represents the official interpretation which the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, has placed and still places upon the Gift Tax Act of 1924. The revocation of G. C. M. 14774 was necessary simply as a matter of mechanics in order to permit the issuance of the ninety-day notice in the *Sanford* case, and did not constitute any public or formal change of attitude on the part of the Treasury.

The Departmental Practice.

The Stipulation of Facts in this case contains the following paragraph (R. 13):

> "9. In his administration of the Gift Tax Act of 1924 and the Gift Tax Act of 1932, and prior to the promulgation of the decision in the case of *Hesslein* v. *Hoey*, 91 Fed. (2) 954, decided July 26, 1937, it has been the uniform practice of the Commissioner of Internal Revenue in adjusting cases of the character of that here involved to treat the taxable transfer subject to the gift tax as occurring when the transferor re-

linquished all power to revest in himself title to the property constituting the subject of the transfer. It is estimated that approximately 300 cases of such character have been closed or were adjusted in accordance with the above practice."

The Meager Record in the Hesslein Case.

Unlike the present record, the record in the *Hesslein* case was very meager. The *Hesslein* case was decided on a motion to dismiss the complaint as insufficient. The Circuit Court of Appeals for the Second Circuit did not have before it (and in denying the Government's application for certiorari this Court did not have before it) the care with which the Treasury considered the question in the *Stanford* case, terminating in the second and favorable ruling; it did not have before it the uniformity of the Commissioner's Regulations since 1924, and the consistent and uniform practice of the Commissioner in administering the Gift Tax Acts; and it did not have before it the illuminating comments made in Congress at the time of the enactment of the Gift Tax Act of 1924, definitely sustaining our interpretation of the statute (see *infra*, p. 37).

The Decisions Below.

The Court below did not undertake to fortify its decision by any independent reasoning. After saying that it "favored the view" which we advanced, it concluded, somewhat inconsistently we submit, by adopting the reasoning of the majority opinion in *Hesslein v. Hoey*. In the course of the Court's opinion, Judge Thompson, speaking for himself and Judges Buffington and Davis, said of the *Hesslein* case (R. 177):

"Despite a dissent by one of the Circuit Court

> Judges, the Supreme Court denied certiorari (302 U. S. 756). Had it not been for the ruling by the Second Circuit and the action of the Supreme Court in denying certiorari, we would have favored the view that the tax was imposed on the transfer of property and that the transfer took place when the trustee was given such possession that the settlor could not regain it for himself or his estate."

The decision in the *Humphreys* case (set for argument directly following this case) was a *per curiam* opinion, affirming the action of the District Court for the Eastern District of New York on the basis of the *Hesslein* case (101 F. (2d) 1012).

The Errors Alleged.

1. The Circuit Court of Appeals erred in holding that Sanford's relinquishment on August 21, 1924, of all further power to modify the trusts constituted a taxable transfer in 1924, when in 1919, some five years before, Sanford had unequivocally surrendered any and all power to revest in himself the corpus or income of the trusts.

2. The Circuit Court of Appeals erred in holding that where the settlor of certain trusts surrendered the power of revocation many years prior to the enactment of any Federal Gift Tax Act, retaining only a power to modify which expressly excluded any right to revest in himself income or corpus of the trusts, the surrender of such a power to modify in a subsequent year when a gift tax was in effect constituted a taxable transfer in such subsequent year.

Summary of Argument.

Since Sanford in 1919 had divested himself of all power to retake for himself income or corpus of the trusts, the surrender in 1924 of the remaining non-beneficial power to modify did not constitute a taxable transfer within the meaning of the Gift Tax Act of 1924.

1.

The incidence of the gift tax is upon the transfer by the donor and not upon the receipt by the beneficial taker. This is the language of the Gift Tax Act of 1924, and the formal Regulations issued by the Commissioner interpreting the Gift Tax Act of 1924 adopt this rule in the case of gifts in trust subject to reserved powers. The Gift Tax Act of 1932 constituted a reenactment of the earlier law in identical language, thus implying Congressional approval of the Commissioner's 1924 Regulations; and in addition the 1932 Act incorporated into the statute as a new paragraph the actual language of the Regulations of the Commissioner issued under the 1924 Act. In *Burnet* v. *Guggenheim,* 288 U. S. 280, 283, this Court, in speaking of the 1924 Regulations, said that "the regulation, and the later statute continuing it, are declaratory of the law which Congress meant to establish in 1924."

2.

The rule of the decision below is a rule of tax postponement and tax avoidance, and directly at variance with the intention of Congress, implied and expressed.

Whatever the decision in this case, it must necessarily control all future transfers of like character. The transfer occurring on the termination of the grantor's power to revest in himself principal and

income of a trust concededly is an act on which a gift tax may be laid, and accordingly to delay the imposition of the gift tax until th later surrender of the remaining power to modify is, at best, a doctrine of tax postponement. Moreover, under Section 219(g) of the Income Tax Title the burden of paying income taxes shifts from the settlor to the trust estate at the point when the settlor relinquishes "the power to revest in himself title to any part of the corpus of the trust." Consequently, to withhold the imposition of the gift tax at this point and impose it at a later date when the remaining power to modify is surrendered would render the gift tax inharmonious with the income tax provisions and would permit widespread and flagrant income surtax avoidance. It could hardly have been the intention of Congress to have the gift tax applied in a manner productive of such results.

The rule of the Court below does not supplement or protect the estate tax to any greater degree than the rule for which we contend. In the case of a gift in trust, whether the gift tax is imposed at the time the grantor surrenders the right to revest in himself, or, later, when he surrenders the remaining power, under either rule if any power remains outstanding at death an estate tax will be collectible, subject to the statutory credits if a gift tax has already been paid. On the other hand, if all powers are surrendered prior to death, thus excluding the corpus from the estate tax, a gift tax necessarily will have been collected on the full corpus of the trust.

The debates in Congress occurring at the time of the enactment of the Gift Tax Act of 1924 and the House and Senate Committee Reports accompanying the enactment of the Gift Tax Act of 1932 evidence a legislative intent directly in conflict with the decision below.

3.

The decisions of this Court in *Burnet* v. *Guggenheim,* 288 U. S. 280 (1933), and *Porter* v. *Commissioner,* 288 U. S. 436 (1933), establish the principle for which we contend.

4.

The reasoning advanced in the majority opinion in the *Hesslein* case, adopted by the Court below, is fallacious and in conflict with the applicable decisions of this Court.

ARGUMENT.

SINCE SANFORD IN 1919 HAD DIVESTED HIMSELF OF ALL POWER TO RETAKE FOR HIMSELF INCOME OR CORPUS OF THE TRUSTS, THE SURRENDER IN 1924 OF THE REMAINING POWER TO MODIFY DID NOT CONSTITUTE A TAXABLE TRANSFER WITHIN THE MEANING OF THE GIFT TAX ACT OF 1924.

Preliminary Comments.

Sanford performed three acts with respect to the property in trust which are material, namely, (1) in 1913 he created the trusts, reserving an unrestricted power of revocation and modification; (2) in 1919 he irrevocably divested himself of all power to withdraw principal or income from the trusts, but reserved the right to modify in other respects; and (3) in 1924 he surrendered the remaining right to modify. Concededly at one of these three points Sanford made a transfer of property by way of gift. This Court has already held that the taxable transfer did not occur on the creation in 1913 of the revocable trusts. *Burnet*

v. *Guggenheim*, 288 U. S. 280 (1933). The question is thus narrowed down to whether the transfer susceptible of sustaining a gift tax occurred on November 26, 1919, or on August 21, 1924.

The *Guggenheim* case† arose under the Gift Tax Act of 1924, and involved a trust originally revocable but later made irrevocable by the surrender of the reserved power. The power reserved and later surrendered was a power "to revoke, modify or alter". We shall discuss the *Guggenheim* case at greater length (*infra*, p. 41), for we respectfully suggest that in principle the decision controls the case here. But the important point is that Mr. Justice Cardozo, who wrote for the Court, laid down certain fundamental principles which are applicable generally to all cases of gifts in trust. "Congress", he said, "did not mean that the tax should be paid twice, or partly at one time and partly at another.". And again, "There must be a choice, and a consistent choice, between the one date and the other. To arrive at a decision, we have therefore to put to ourselves the question, which choice is it the more likely that Congress would have made?" In selecting the date when the power of revocation was surrendered rather than the date when the revocable trust was created, Mr. Justice Cardozo concluded that the statute "is aimed at transfers of the title that have the quality of a gift, and a gift is not consummate until put beyond recall."

Thus Mr. Justice Cardozo made it abundantly clear that in the case of a gift in trust one gift tax and only one is imposed, and that in selecting the date "a choice, and a consistent choice" must be made. The question is "which choice is it the more likely that

† See page 41, *infra*, for a statement of the case.

Congress would have made?" The question is not one of Congressional power; it is a question of the intention of Congress, and in resolving it the intention of Congress must control.

In approaching the question, the possibility of a shifting of interest among the beneficiaries on account of the existence of the limited power to modify must not be confused with the validity of the gifts as such. The trusts here involved, the trust involved in the *Hesslein* case, and the trust involved in the *Humphreys* case were all valid and enforceable trusts; none of them failed for the lack of a donee, namely, the trustee representing the trust estate, capable of taking, holding and administering the trust corpus. Once the grantor surrendered all power to revest in himself the principal and income of the trusts, there was a finality of transfer and a reality in the gift, which was entirely lacking so long as the power to revoke remained outstanding.

Nevertheless, the Court below, on the reasoning in the *Hesslein* case, in effect concluded that it was not the intention of the statute to impose a tax until the gift was "complete", and that a gift in trust is not "complete" until the surrender of the power to change the beneficial takers. This in effect amounts to saying that Congress in laying the tax on gifts did not intend to impose it upon the *transfer* of the property *from* the donor, but intended, rather, to withhold the tax until the ultimate beneficial takers were finally fixed.

I.

The incidence of the gift tax is upon the transfer by the donor and not upon the receipt by the beneficial taker; and in the case of gifts in trust the taxable transfer occurs on the surrender of the power to retake.

The Statute.

The language of Section 319 of the Revenue Act of 1924 imposing the tax on gifts is clear and unambiguous:

> "* * * a tax * * * is hereby imposed upon the transfer * * * by gift * * * of any property * * *."

Thus the expressed incidence of the tax is upon the transfer by the donor and not upon the receipt by the ultimate beneficial taker. Clearer language is hardly conceivable. Short of adding a negative clause such as "and not upon the receipt of the property", it is hard to imagine language which could more clearly impose the tax upon the transfer as distinguished from the receipt.

By Section 324 it was expressly provided that the tax "shall be paid by the donor", thus confirming the intention of laying the tax on the transfer rather than on the receipt.

Clearly the tax is an excise on the right of making a "transfer" by way of gift.

The Commissioner's Regulations.

The language of Section 319 does not cover in terms gifts in trust. But from the enactment of the statute in 1924, the Commissioner of Internal Revenue consistently has interpreted the statute as applicable to gifts in trust in accordance with the language of

transfer, and has imposed the tax at the point where the grantor irrevocably parts with the property, terminating all power to revest in himself title to the corpus of the trust.

On November 8, 1924, the Commissioner of Internal Revenue, in pursuance of his authority to issue "all needful rules and regulations for the enforcement of this Act",† promulgated his formal regulations covering the case of gifts in trust. These comprise Article 1 of Regulations 67 (1924 edition) (See Appendix, p. 64, *infra*). Article 1 provides that on the creation of a trust "where the grantor retains the power to revest in himself title to the corpus of the trust" no gift subject to tax occurs, but—

> "Where the power retained by the grantor to revest in himself title to the corpus is not exercised a taxable transfer will be treated as taking place in the year in which such power is terminated."

Thus in the very atmosphere which attended the passage of the Gift Tax Act, the Commissioner of Internal Revenue placed an interpretation upon the Act which clearly and succinctly and without ambiguity prescribed the rule for which we contend.

The Chief Counsel for the Bureau of Internal Revenue has so construed the Commissioner's Regulations. In the second *Sanford* ruling (G. C. M. 14774), he quoted Article 1 of Regulations 67 and laid his opinion squarely upon the Regulations. Again, in G. C. M. 19260, the memorandum directing the issuance of the 90-day letter following the decision in the *Hesslein* case, the Chief Counsel specifically said (R. 30): "G. C. M. 14774 gives full effect to the regulations." Nor could he have said otherwise, for

† See Section 1001 of the Revenue Act of 1924.

if, as the Regulations provide, the tax attaches "Where the power retained by the grantor to revest in himself title to the corpus is * * * terminated", it must necessarily attach on the occurrence of the prescribed event, regardless of the retention or non-retention of another kind of power. Article 1 of Regulations 67 is clear and unambiguous.†

Article 1 of Regulations 67 (1924 edition) remains in full force and effect, unaltered and unamended, even to this day.

Legislative Approval of the Regulations.

The permanence of this Regulation is not surprising, for the rule of the Regulation has received explicit Congressional approval, as evidenced, first, by the reenactment of the Gift Tax Act of 1932 in the same language as the 1924 Act, and, second, by the incorporation in the later statute of a new section (Section 501(c)) which expressly adopted the language of the 1924 Regulation.

With Article 1 of Regulations 67 (1924 edition) formally promulgated and outstanding, Congress in 1932 reimposed the tax on gifts, and in doing so used the same language as in Section 319 of the 1924 Act. Section 501(a) of the 1932 Act laid—

> "* * * a tax * * * upon the transfer * * * of property by gift * * *."††

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† The Court below, after quoting this Article, said (R. 176-7): "This is a negative provision that the gift is not completed if the settlor retains the power to revest the corpus of the trust in himself." On the contrary, we submit that the regulation constitutes an affirmative declaration, for it unequivocally states that the taxable transfer "will be treated as taking place in the year in which such power is terminated".

†† The language of the 1924 Act was:

> "* * * a tax * * * upon the transfer * * * by gift * * * of any property."

But in order that all doubt might be removed as to its intention to adopt the rule of the earlier Regulations, Congress incorporated into the 1932 Act a new section, Section 501(c). This section provided:

> "(c) The tax shall not apply to a transfer of property in trust where the power to revest in the donor title to such property is vested in the donor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such property or the income therefrom, but the relinquishment or termination of such power (other than by the donor's death) shall be considered to be a transfer by the donor by gift of the property subject to such power, * * *."

This was the situation when this Court considered the application of the Gift Tax Act of 1924 to the case of a gift in trust in the *Guggenheim* case. In the course of his opinion, Mr. Justice Cardozo considered with care Article 1 of Regulations 67 (1924 edition) and the incorporation of the language of this Regulation in Section 501(c) of the Revenue Act of 1932. After quoting Article 1 of Regulations 67, he said (p. 283):

> "The substance of this regulation has now been carried forward into the Revenue Act of 1932, which will give the rule for later transfers [citing Section 501 (c) of the Revenue Act of 1932]."

and he then added:

> "We think the regulation, and the later statute continuing it [*i. e.,* Section 501 (c) of the 1932 Revenue Act], are declaratory of the law which Congress meant to establish in 1924."

Following the decision of this Court in the *Guggenheim* case, and in fact directly on account of the statements made by Mr. Justice Cardozo, Congress repealed Section 501(c) of the Revenue Act of 1932† as no longer necessary. In the House Ways and Means Committee Report and in the Senate Finance Committee Report accompanying the Revenue Bill of 1934, the two committees said:††

> "This section repeals section 501 (c) of the Revenue Act of 1932, since the principle expressed in that section is now a fundamental part of the law by virtue of the Supreme Court's decision in the *Guggenheim case* (53 S. Ct. 369)."

In the face of such a record, it is hard to conceive of a clearer case of legislative approval of the rule prescribed by the Commissioner in his Regulations.

The 1932 Regulations.

The Regulations of the Commissioner issued under the Revenue Act of 1932 adopted and continued the rule of the 1924 Regulations. Article 3 of Regulations 79 (1933 edition), as in the case of the 1924 Regulations, provided that—

> "The relinquishment or termination * * * of the power to revest in the donor title to property transferred in trust, is a gift of such property at the time of the relinquishment or termination of the power * * *."

These were the Regulations which were before the Second Circuit in the *Hesslein* case. Conceding that

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† See Section 511 of the Revenue Act of 1934.

†† House Report No. 704, 73d Cong., 2d Sess., p. 40; Senate Report No. 558, 73d Cong., 2d Sess., p. 50.

they squarely covered the case involved, Judge Swan nevertheless ignored them on the ground that they were "of recent adoption and have not the sanction which would result from a subsequent reenactment of the statute". If Judge Swan had been conscious of the permanency of the rule since 1924 and of its history, he hardly could have made such a comment.

Subsequently, the Commissioner amended and amplified Article 3 of Regulations 79 in the 1936 edition. But the fundamental rule involving transfers in trust was retained and continued.

The Departmental Practice Consistently and Uniformly Applied for Some Thirteen Years.

As a matter of administration practice, from the enactment of the Gift Tax Act on June 2, 1924, until the *Hesslein* decision was announced in 1937, the Commissioner never departed from the rule announced in his formal Regulations in adjusting individual cases of this character, including this very case itself.

The stipulated facts of record unqualifiedly testify to the uniform and uninterrupted course of the departmental practice (R. 13-14). In his administration of the Gift Tax Acts of 1924 and 1932, reads the stipulation, and up until the time the Circuit Court of Appeals for the Second Circuit decided the *Hesslein* case on July 26, 1937, it has been the "uniform practice of the Commissioner of Internal Revenue in adjusting cases of the character of that here involved" to treat the taxable transfer subject to the gift tax as occurring when and only when "the transferor relinquished all power to revest in himself title to the property constituting the subject of the transfer";

and approximately 300 cases of this character, so recites the stipulation, have been closed or were adjusted in accordance with this practice.

The Authorities.

Under the established rule of the decisions of this Court, such a uniformity in published formal regulation and departmental practice as is presented in this case will not be disturbed unless clearly inconsistent with the language of the statute. *Hassett* v. *Welch*, 303 U. S. 303, 312 (1938); *Logan* v. *Davis*, 233 U. S. 613, 627 (1914); *United States* v. *Moore*, 95 U. S. 760, 763 (1877); *Dismuke* v. *United States*, 297 U. S. 167, 174 (1936); *Norwegian Nitrogen Co.* v. *United States*, 288 U. S. 294, 315 (1933); *United States* v. *Alabama Railroad*, 142 U. S. 615, 621 (1892); *Brewster* v. *Gage*, 280 U. S. 327, 336 (1930); *Fawcus Machine Co.* v. *United States*, 282 U. S. 375, 378 (1931).

Where Congress has reenacted the statute without alteration following the promulgation of the formal Regulation, the administrative interpretation placed upon the Act is of even more compelling weight, for, as this Court said in *Massachusetts Mutual Life Insurance Company* v. *United States*, 288 U. S. 269, 273 (1933) (an income tax case) the action of Congress—

> "was taken with knowledge of the construction placed upon the section by the official charged with its administration. If the legislative body had considered the Treasury interpretation erroneous it would have amended the section. Its failure so to do requires the conclusion that the regulation was not inconsistent with the intent of the statute."

In *Koshland* v. *Helvering,* 298 U. S. 441, it was said (p. 445):

> "We give great weight to an administrative interpretation long and consistently followed, particularly when the Congress, presumably with that construction in mind, has reenacted the statute without change."

Perhaps the most forceful application of the principle appears in *Helvering* v. *Reynolds Tobacco Co.*, 306 U. S. 110, decided during the last term of this Court. The *Reynolds Tobacco Co.* case involved the question whether a corporation realizes gain or loss on the purchase and sale of its own stock. From 1920 to 1934, the administrative construction placed upon the applicable provision of the revenue laws as set forth in the Regulations of the Commissioner was uniform and consistent. In 1934, the Commissioner changed the Regulations retroactively. In upholding the interpretation adopted in the original Regulations, this Court announced the rule that since such Regulations had received legislative approval by reenactment of the underlying statutory provisions, the Regulations had the force of law and, therefore (p. 116)—

> "* * * Congress did not intend to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed."

The principle underlying the *Reynolds Tobacco Co.* case is even more persuasive here, since the Commissioner has never undertaken to change or modify his Regulations promulgated under the Gift Tax Act of 1924, but such Regulations remain outstanding today, unaltered and unamended.

To delay the gift tax until the surrender of the limited power to modify, as the Court below has

decreed, is to ignore the force and effect of an unambiguous Regulation and the consistent administrative practice followed for thirteen years; to ignore the clear legislative approval of the Regulation by the enactment of the second Gift Tax Act without change of language and the deliberate and express incorporation in that Act of the language of the Regulation; and to ignore the statement of this Court in the *Guggenheim* case (p. 283) that "the regulation, and the later statute continuing it, are declaratory of the law which Congress meant to establish in 1924".

II.

The rule of the decision below is a rule of tax postponement and tax avoidance, and directly at variance with the intention of Congress, implied and expressed.

Whichever rule is adopted in this case must necessarily control all future transfers of similar character.

The Gift Tax Act of 1924 was the first Federal Gift Tax Act. It was approved June 2, 1924, and was repealed as of December 31, 1925. The tax on gifts was reenacted as part of the Revenue Act of 1932. The second Act went into effect on June 6, 1932, and since has remained in effect. While somewhat tardy in its permanent arrival, the Federal tax on gifts is now a component part of our system of Federal taxation. In the Federal scheme there are, therefore, three main classes of taxes, the income tax, the estate tax and the gift tax. Since each is a component part of the larger whole, all must be interpreted and applied together, for otherwise loopholes will occur and inconsistencies arise.

The rule of the Court below, if adopted, would

result in tax postponement and tax avoidance. It would result in unnecessarily postponing the taxes on gifts, if not wholly frustrating such taxes; and unquestionably it would result in widespread and flagrant avoidance of Federal income taxes. Surely it could not have been the intention of Congress to have the Gift Tax Act interpreted in such a manner.

(a)

THE RULE OF THE COURT BELOW WOULD POSTPONE, IF NOT WHOLLY FRUSTRATE, THE COLLECTION OF GIFT TAXES.

Concededly the transfer occurring when a grantor surrenders the power to revest in himself income or corpus of a trust is a transfer which will support the imposition of a gift tax, even though the grantor retains a limited power to modify in other respects. But if the taxing power of the Government is withheld and a gift tax is not imposed until the surrender of the remaining power, undeniably postponement and presumably frustration of the tax on gifts will occur. Where a taxpayer desires to make a gift without subjecting himself to the burden of the gift tax, it does not require a very discerning eye for him to see that he may do so by the simple device of creating a trust, under the terms of which he retains a bare power to modify except in favor of himself or his estate, which power he need never surrender nor exercise. It would be strange, indeed, if Congress intended to legalize such a device, when the imposition of the gift tax at the time of the earlier relinquishment of the power to revest would definitely prevent it.

(b)

The rule of the Court below is inharmonious with the income tax provisions of the Revenue Acts, and would result in widespread income tax avoidance.

The Gift Tax Act of 1924 was enacted as Part II of Title III of the Revenue Act of 1924. The income tax provisions were Title II. By imposing the gift tax on "the transfer * * * of any property" (as distinguished from the receipt), Congress brought the gift tax provisions and the income tax provisions into complete harmony in respect of trusts subject to reserved powers. In the 1924 Act, the Income Tax Title was amended by adding a new section, 219(g), which read as follows:

> "Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, *the power to revest in himself title to any part of the corpus of the trust*, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor." (Italics supplied.)†

That is to say, in the case of a trust, where the grantor retains "the power to revest in himself title to any part of the corpus of the trust", the income of the trust, although received by someone other than the grantor, nevertheless, is taxable to the grantor. The principle justifying such a rule is that on ac-

† In drafting the 1924 Gift Tax Regulations, the Commissioner had before him the language of this new income tax section, and unquestionably was aware of the considerations implicit in the two Titles of the Act.

count of the reserved power, the grantor can at any time retake the corpus and hence exercises complete control for himself over the income. *Corliss* v. *Bowers*, 281 U. S. 376.

On the other hand, under the clear implication of the language of Section 219(g), when the grantor ceases to have "the power to revest in himself title to any part of the corpus of the trust", the burden of paying the income tax in respect of the income from the trust shifts from the grantor to the trust estate and falls either upon the beneficiaries or upon the trustee, a rule which has been consistently applied by the courts and the Board of Tax Appeals. *Knapp* v. *Hoey*, 24 Fed. Supp. 39, affirmed C. C. A. 2nd C., May 22, 1939, 104 F. (2d) 99; *Phebe W. M. Downs*, 36 B. T. A. 1129; *Thomas H. Blodgett*, 37 B. T. A. 1333 (Memo. Dec. reported in 1938 Com. Cl. H. Dec. 10004-B, p. 26080).

Thus, for income tax purposes, the test is the existence or absence of the grantor's *control* over the corpus (and hence the income) *for himself*.

This being the income tax rule, if the gift tax is postponed until the surrender of a limited power of modification, the gift tax is entirely out of harmony with the income tax and will result in flagrant and widespread income tax avoidance. Under such a rule, any wealthy individual may readily relieve himself of burdensome surtaxes by the simple device of making gifts in trust for members of his immediate family or friends, in which he relinquishes the power to revest in himself income and principal but reserves a limited power to modify, such as the power to change beneficiaries, which, of course, need never be exercised nor surrendered. Thereby he shifts the burden of paying the income tax from himself to

the trust estate, thus effecting a saving of income taxes by reducing the rates applicable, and at the same time he faces no gift taxes so long as the retained power remains outstanding.

This very case has already arisen in *Knapp* v. *Hoey*, *supra*, (the District Court for the Southern District of New York). In 1929, Knapp created a trust, reserving broad powers to change the beneficiaries and to modify their interests, but "in no event shall any such modification or alteration direct that the said income be paid to or applied to the use or benefit of the party of the first part [the grantor]." With the *Hesslein* case before him, the Commissioner attempted to tax Knapp on the income from the trust received in 1932. Judge Patterson, then still on the District Court bench, finding that "the trust was not revocable" and that "no power was reserved by the grantor to revest in himself title to any part of the corpus", held that Knapp was not liable for the tax, adding (p. 41):

> "It requires no great discernment to see that the plaintiff in setting up this trust had an eye on the revenue laws. While he went far in retaining control of the property, he stopped short of control broad enough to render the income taxable as his own. The fact that the creation of the trust was a plan for reducing his income tax and at the same time retaining a measure of control over the property does not make the income of the trust taxable as his income under existing laws."

The Circuit Court of Appeals for the Second Circuit affirmed, Judge Augustus N. Hand writing for himself and Judges Learned Hand and Swan. The Circuit Court laid its decision squarely upon the

principle that under the terms of the trust the settlor was powerless to retake income or principal for himself, saying:

> "The clause just quoted would prevent the settlor from exercising his power so as to acquire income whether directly or indirectly in violation of the purpose of the prescribed limitation. Cf. *Higgins* v. *White*, 93 F. (2d) 357 (CCA1)."

The Court did not refer to its earlier decision in the *Hesslein* case.

The Government did not apply for a writ of certiorari in the *Knapp* case.

Thus under the rule of the Court below, by the simple device of an irrevocable gift in trust subject to a reserved power to change the beneficiaries, a wealthy individual may make substantial and irrevocable transfers to his family or friends and thus accomplish very large income tax savings, without facing any deterrent in the form of an immediate gift tax. Unquestionably such a rule would result in flagrant income tax avoidance and render the gift tax largely unproductive of revenue.†

The Treasury, in considering the *Sanford* case, was quick to see the magnitude of such a loophole. In submitting the second and favorable *Sanford* rul-

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† If the rule of the Court below should be finally established, even Congress would not be able effectively to close the loophole. It might, of course, undertake to amend the Gift Tax Act and make it in terms apply at the point when the grantor no longer can retake for himself the property (the rule for which we here contend); but any such change could not be made retroactive. *Nichols* v. *Coolidge*, 274 U. S. 531 (1927), *Untermyer* v. *Anderson*, 276 U. S. 440 (1928), *Helvering* v. *Helmholz*, 296 U. S. 93 (1935). On the other hand, any amendment of Section 219(g) undertaking to impose income taxes on the grantor after he has lost the right to revest in himself corpus or income would be

ing (G.C.M. 14774) to the Under Secretary of the Treasury, a high Treasury official wrote (R. 28):

> "I am now convinced that the position tentatively taken in the prior opinion should not be maintained, and that its possible prejudicial results upon the revenues both from gift tax and income tax far outweigh the considerable revenue we would gain from asserting a gift tax liability against this trust."

If, however, the gift tax is imposed when the power to revest is surrendered, that is, at the point when the burden of the income tax shifts from the grantor to the trust estate, benefit will be combined with burden, and the gift tax and the income tax will be brought into complete harmony.

(c)

THE RULE OF THE COURT BELOW DOES NOT SUPPLEMENT OR PROTECT THE ESTATE TAX TO ANY GREATER DEGREE THAN THE RULE FOR WHICH WE CONTEND.

In framing the Revenue Act of 1924, Congress added a new section to the estate tax provisions, namely, Section 302(d). Under this amendment, the

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beyond the power of Congress. As the Government said in its brief in the Court below (p. 37):

> "In order to justify taxing the grantor on income of a trust which is not in terms payable to him, it is obvious that he must have command of the trust corpus or of the trust income for his own use or for a use which satisfies one of his obligations. *Douglas* v. *Willcuts*, 296 U. S. 1; *Corliss* v. *Bowers*, 281 U. S. 376. That was the precise theory upon which *Knapp* v. *Hoey* (S. D. N. Y.), reported in 1938 C. C. H., Vol. 4, Par. 9368, was decided. A tax cannot constitutionally be imposed on one person with respect to income which belongs wholly to another (*Poe* v. *Seaborn*, 282 U. S. 101; *Hoeper* v. *Tax Commission*, 284 U. S. 206)."

gross estate of a decedent must include the value at the time of his death of all property—

> "(d) To the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for a fair consideration in money or money's worth;"

Thus under the statute as it now exists, for estate tax purposes a transfer in trust subject at death to a reserved power "to alter, amend or revoke" is part of the gross estate. Construing this Section, this Court has held that the quoted phrase is disjunctive, and that where the grantor at death retains only a non-beneficial or limited power to alter in favor of others (as distinguished from a power to revest in himself), the corpus of the trust nevertheless must be included in the gross estate. *Porter* v. *Commissioner,* 288 U. S. 436.†

This being the state of the law, the gift tax will supplement and protect the estate tax equally well, whether the gift tax is imposed when the grantor relinquishes the right to revest in himself the principal

† In the course of its opinion in the *Porter* case, this Court pointed out (p. 442) that prior to the enactment of Section 302(d) covering transfers subject at death to a power "to alter, amend or revoke", it had already held that the existence at death of a power of revocation over a trust required the inclusion of the corpus in the gross estate within subdivision (c) taxing "transfers" intended to take effect on death, citing *Reinecke* v. *Northern Trust Co.,* 278 U. S. 339, 345. Accordingly, (c) and (d) overlap to the extent that both cover transfers subject to a power of revocation. Subdivision (d) goes beyond (c) in including a transfer subject to a non-beneficial power to alter or amend.

and income, or, at the later date, when he relinquishes the remaining power to alter or modify. In the case of the creation of an *inter vivos* trust, if any power remains outstanding at death, whether a power of revocation and revestment, or merely a limited power to alter or amend, the trust corpus will fall within the gross estate for estate tax purposes under the provisions of Section 302(d), subject, however, to the statutory gift tax credits prescribed in Section 322 of the Revenue Act of 1924 in the event of the payment of a prior gift tax. If, however, no power remains outstanding at death, that is to say, if prior to death all power over the disposition of principal and income has been surrendered, the corpus is not a part of the gross estate. But, under such circumstances, a gift tax necessarily must have been paid prior to the point when the property was removed from the scope of the estate tax, regardless of whether the gift tax is imposed at the time of the surrender of the power to revest, or, later, on the surrender of the remaining power to modify. Accordingly, whichever the choice may be as to the date on which the gift tax is imposed, the gift tax will implement the estate tax equally well, for in either case, the collection of a gift tax on the full corpus of the trust is assured before the corpus is excluded from the gross estate.

(d)

THE DEBATES IN CONGRESS OCCURRING AT THE TIME OF THE ENACTMENT OF THE GIFT TAX ACT OF 1924 EXPRESSLY EVIDENCE A LEGISLATIVE INTENT DIRECTLY IN CONFLICT WITH THE DECISION BELOW.

In drafting the Revenue Bill of 1924, the Ways and Means Committee of the House, led by Representa-

tive Ogden Mills, defeated an effort of Representative Green, Chairman of the Committee, to include in the Bill any gift tax provisions. Similarly, when the Senate Finance Committee was considering the Bill, the effort of Senator Walsh of Massachusetts to include a gift tax provision was defeated in committee. But when the Revenue Bill of 1924 was introduced on the floor of the two Houses, Representative Green in the House and Senator Walsh in the Senate introduced an amendment which ultimately was enacted as the Gift Tax Act of 1924, and in the course of the debates on the Revenue Bill in the House and Senate, Representative Green, Senator Walsh, and Representative (now Vice President) Garner, also an earnest advocate of the bill, repeatedly made statements which indicate clearly the purpose of Congress in enacting the gift tax provisions.

Statements on the floor of the House and Senate by those sponsoring a measure, particularly where, as here, the bill which later became law was introduced as an amendment when the main bill reached the floor of the two Houses, are entitled to weighty consideration in determining the intention of Congress. *Hassett* v. *Welch*, 303 U. S. 303, 312 (1938); *Wright* v. *Vinton Branch*, 300 U. S. 440, 463 (1937); *Humphrey's Executor* v. *United States*, 295 U. S. 602, 625 (1935); *Richbourg Motor Co.* v. *United States*, 281 U. S. 528, 536 (1930); *Duplex Printing Press Co.* v. *Deering*, 254 U. S. 443, 475 (1921). In *Wright* v. *Vinton Branch, supra*, this Court said in part (footnote, pp. 463-4):

> "Where the meaning of legislation is doubtful or obscure, resort may be had in its interpretation to reports of Congressional committees which have considered the measure, * * *; to exposition of the bill on the floor of Congress by those in

charge of or sponsoring the legislation, * * *; to comparison of successive drafts or amendments of the measure, * * *; and to the debates in general in order to show common agreement on purpose as distinguished from interpretation of particular phraseology, * * *."

Fortunately, those sponsoring the new gift tax amendment made abundantly clear the major purposes of Congress in enacting such legislation. Representative Green, in offering the bill on the floor of the House, stated that the proposed amendment taxing gifts was a corollary of the estate tax necessary to prevent estate tax avoidance, and then continued (65 Cong. Rec., 1st Sess., 3120):

> "This amendment also is needed on account of the income tax. The splitting up of large estates, of course, reduces the amount of surtaxes to be laid upon the party who so divides them. We have lost more, in my judgment, by the division of these large estates in our income taxes than we have lost by reason of tax-exempt securities, and we have lost millions upon millions by reason of tax-exempt securities."

And again he said (65 Cong. Rec., 1st Sess., 3172):

> "* * * I have been laboring to get it [the gift tax] inserted in the law, because I knew just exactly what would happen, namely, that these big estates would be gradually split up into different parts, thereby defeating both the income tax and the inheritance tax, and that is the reason our revenues are so rapidly decreasing from the big estates."

Representative Garner said in the course of the debate (65 Cong. Rec., 1st Sess., 3173):

> "The gentleman from New York [Ogden Mills] knows that this amendment if it is adopted will

prevent the transferring of large estates and avoiding paying estate taxes, that it will prevent the dividing up of large estates, and therefore escape from the high surtaxes. Those are the two things it will do, and in doing that in my opinion it will raise twenty-five million dollars in the Treasury next year."

Senator Walsh, who introduced the gift tax bill on the floor of the Senate, said (65 Cong. Rec., 1st Sess., 8095, 8096):

"The gift tax would serve as a safeguard for two important sections of this bill, namely, the estate tax and the personal income tax. It will go a long way toward preventing evasion of both of those taxes by the transfer of possession to relatives or friends for the purpose of reducing incomes or estates so as to bring them within a tax bracket where they would be subject to lower tax rates.

* * * * * * *

"The purpose of gifts inter vivos is to lower the income tax by splitting up the volume of the taxable property.

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"Mr. President, I wish to say a few words further in order to illustrate the manner in which gifts are used to evade income and inheritance taxes.

Suppose Jones enjoys the income from $1,000,000, or $50,000 per year. The normal tax and the surtax at the rates adopted by the Senate are $6,137.50. If Jones gives his wife half of his property, or $500,000, in trust or otherwise, the income taxes on the $25,000 of income which each spouse will receive will be $1,547.50, or a total saving in taxes on the income of the husband and wife of $3,042.50. The saving in the

cases of larger incomes will be proportionately greater as the surtaxes increase. It can not be doubted, therefore, that if we are to make the tax laws effective, we must place some tax upon the gifts which are now being used to evade them."

Senator Simmons of North Carolina in the course of the debate also said (65 Cong. Rec., 1st Sess., 8096):

> "There are two kinds of taxes which we find it necessary to levy in the conditions which now obtain. One is the income tax, the other is the inheritance tax. From both of those taxes the Government realizes a very large amount of revenue, revenue that it can not dispense with, that is absolutely necessary to enable us to finance the Government. One of the favorite methods of evading the income tax is through the splitting up of large incomes among members of the family, thus evading the higher rates imposed by surtaxes. That has been very generally resorted to especially by men of large incomes and the Government has lost an immense amount of revenue through that means of evasion."

While general in character, these comments did not overlook the effect of accomplishing gifts by the creation of trusts, for Senator Walsh of Massachusetts in the course of formulating his example of reducing income taxes by making a gift to a wife, quoted above, referred to the suggested gift as "in trust or otherwise".

Again, when the Revenue Bill of 1932 was reported out of Committee, the Committee Reports of both Houses† contained the following statement:

> "The gift tax will supplement both the estate

† House Rep. No. 708, 72nd Cong., 1st Sess., p. 28; Sen. Rep. No. 665, 72nd Cong., 1st Sess., p. 40.

tax and the income tax. It will tend to reduce the incentive to make gifts in order that distribution of future income from the donated property may be to a number of persons with the result that the taxes imposed by the higher brackets of the income tax law are avoided. It will also tend to discourage transfers for the purpose of avoiding the estate tax."

This expressed purpose in the enactment of the statute and the very apparent need for harmonizing the gift tax and the income tax did not escape the Commissioner of Internal Revenue. As we have seen (pp. 19-20, 29, *supra*), when the Commissioner came to draft his Regulations covering transfers in trust under the 1924 Act, he adopted a rule under which the gift tax was imposed at the point where the burden of paying income taxes shifted from the grantor to the trust estate, thus making the gift tax operate as a very real deterrent against splitting up large property holdings and so carrying out one of the expressed purposes of Congress in exacting the gift tax as applied to transfers in trust; and in order that there might be no escape from this result, he adopted the actual language of the income tax provisions. He would have been derelict in his duty had he done otherwise. Yet the Court below has repudiated the rule which the Commissioner so carefully framed. and has prescribed a rule which in its operation will defeat one of the declared purposes of Congress in imposing a tax on gifts.

III.

The decisions of this Court in *Burnet* v. *Guggenheim* and *Porter* v. *Commissioner* establish the principle for which we contend.

Judge Swan in his opinion in the *Hesslein* case undertook to distinguish *Burnet* v. *Guggenheim,* 288 U. S. 280, and relied upon *Porter* v. *Commissioner,* 288 U. S. 436, as sustaining his contention that a gift in trust is not "complete" so long as a power to change beneficiaries remains outstanding. We approach with some diffidence the discussion of cases so recently decided by this Court, but we differ so sharply with the interpretation placed upon them by the majority opinion in the *Hesslein* case that some discussion of the cases seems imperative.

The Guggenheim Case.

The decision below is, we submit, in conflict with the *Guggenheim* case; the reasoning of the case, certainly, impels the rule for which we here contend.

Guggenheim created a trust on June 28, 1917, reserving an unrestricted power "to modify, alter or revoke the trusts except as to income, received or accrued." By indenture dated July 19, 1925, Guggenheim surrendered the reserved power. The specific question this Court had before it and decided was whether a transfer subject to the gift tax occurred on the creation of a trust subject to an absolute power to revoke, or later, upon the surrender of such a power. This Court held that in applying the Gift Tax Act substance must control over form, that while the power of revocation remained outstanding the gift was "formal and unreal", that the

transfer did not acquire substance and reality so long as the grantor "was free at any moment, with reason or without, to revest title in himself", and accordingly concluded that the tax attached on the surrender of the reserved power.

Mr. Justice Cardozo focused his attention wholly on the power to revoke and its surrender. In every instance when the Learned Justice made reference to the character of the power, he described it as a "power of revocation" or "the power to revest title in himself", or "irrevocable deed", and such like, and when at the outset of his opinion he posed the question under consideration, he phrased it as follows (p. 281):

> "The question to be decided is whether deeds of trust made in 1917, with a reservation to the grantor of a power of revocation, became taxable as gifts under the Revenue Act of 1924 when in 1925 there was a change of the deeds by the cancellation of the power."

He said that when the settlor executed the original deed of trust he divested himself of title to the property and transferred it to others. But, he continued (p. 284):

> "* * * the substance of his dominion was the same as if these forms had been omitted. *Corliss* v. *Bowers* [281 U. S. 376], *supra*. He was free at any moment, with reason or without, to revest title in himself, except as to any income then collected or accrued. As to the principal of the trusts and as to income to accrue thereafter, the gifts were formal and unreal. They acquired substance and reality for the first time in July, 1925, when the deeds became absolute through the cancellation of the power."

That is to say, it is the relinquishment of the power of revocation which in reality constitutes the gift, and at that point there occurs "the transfer * * * of * * * property", which is the incidence of the gift tax.

Later in the course of his opinion Mr. Justice Cardozo said (p. 286):

> "The statute is not aimed at every transfer of the legal title without consideration. Such a transfer there would be if the trustees were to hold for the use of the grantor. It is aimed at transfers of the title that have the quality of a gift, and a gift is not consummate *until put beyond recall.*" (Italics supplied.)

The clause "put beyond recall" can mean only one thing, the transfer of the property in such a fashion that the grantor under no circumstances can "recall" the property. This is the same conception as that of the words in the Commissioner's Regulations: "to revest *in himself* title to the corpus of the trust". If, as the Learned Justice said, "a gift is not consummate until put beyond recall", the implication is equally clear that *when put beyond recall* the taxable transfer occurs.

The illusory character of a gift subject to a power of revocation runs through the whole opinion and underlies the decision itself. For example, the Learned Justice said (p. 288):

> "To lay the tax at once, while the deed is subject to the power, is to lay it on a gift that may never become consummate in any real or beneficial sense. To lay it later on is to unite benefit with burden."

The point when a gift is consummate in a "real or beneficial sense" is the point when the grantor cannot retake it, when it is "put beyond recall", when

it cannot be destroyed. This occurs on the surrender of the power of revestment, for then there is a complete finality of the gift. That the grantor still may shift the beneficial enjoyment is of no consequence for our purposes. Such a power is a special power in trust,† and forever insures the enjoyment of the property by someone *other than the grantor. Knapp* v. *Commissioner, supra* (p. 31). In the case of an ordinary trust with contingent remainders, unquestionably the gift is a valid and effective gift even though the contingencies are not determined. The same principle applies here.

In the course of his opinion, Mr. Justice Cardozo made certain comments which were misinterpreted by the Circuit Courts of Appeals in these cases. He said (pp. 285-6) that the imposition of a gift tax upon the value of the trust corpus would be a hardship "when nothing has been done to give assurance that any part of the principal will ever go to the donee". In relying upon this statement, the Circuit Courts overlooked the fact that this Court was considering a *revocable* trust, and that the statement was addressed to the contention that a completed gift occurred on the *creation* of a revocable trust. Clearly the statement was not aimed at, and it cannot properly be applied to, a case where the trust has become *irrevocable* by the settlor's surrender of all power to revest in himself income or corpus. In the one case there is in reality no permanent donee, for by exercising the power of revocation the grantor may undo everything that he has done. But after a grantor has surrendered the power to revest corpus and income in him-

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† See New York Real Property Law, §§ 135, 138, and 144 (applicable equally to personal property, *Cutting* v. *Cutting*, 86 N. Y. 522; *Hutton* v. *Benkard*, 92 N. Y. 295).

self, the transfer is final and permanent and a final and permanent donee exists, namely, the trust estate. In such a case, the payment of the tax upon the surrender of the power to revest creates no hardship, whether the tax is collected from the donor or, on the donor's inability to pay, from the trust estate. There exists a definite and final donee and a definite and completed gift in trust, regardless of the power to designate new beneficiaries, since the power cannot be exercised in favor of the grantor and the gift thus destroyed.

Mr. Justice Cardozo also said that the gift tax and the estate tax are closely related in structure and purpose, are parts of the same title, and are in *pari materia.* From the context of this statement in the opinion, it is evident, however, that it was made in support of his assertion that the gift tax, like the estate tax, should not be applied so as to exalt form over substance, for directly after making this comment, he said (p. 287):

> "There is little likelihood that the lawmakers meant to narrow the concept, and to revert to a construction that would exalt the form above the substance, in fixing the scope of a transfer for the purposes of Part II."

And later he added (p. 287):

> "Congress was aware that what was of the essence of a transfer had come to be identified more nearly with a change of economic benefits than with technicalities of title."

In the case of gifts in trust, as he himself makes clear, the change of the economic benefits occurs when the grantor loses the power to retake the corpus and income for himself, for at that point there is a per-

manent shift of the economic benefits from the grantor to persons other than the grantor. The permanence in this shift of economic benefits is not affected by the retention of a non-beneficial power to modify, for while under the power the grantor may redesignate the recipients of his bounty, the gift can neither be recalled nor destroyed.

Quoting Mr. Justice Cardozo's statement that the two taxes are closely related in purpose and structure and are in *pari materia*, Judge Swan in the *Hesslein* case gave to it quite a different implication. From it he concluded that the gift tax and the estate tax should be construed together in the sense that since the estate tax embraces an *inter vivos* transfer subject at death to a limited power to alter or amend, the gift tax should be considered as excluding an *inter vivos* transfer so long as a power to alter or amend remains outstanding. There is no support for such a conclusion. Plainly, Mr. Justice Cardozo advanced the similarity of the two statutes only as lending support to his basic theory that in applying the gift tax substance must control over form.

Moreover, directly following his first reference to the estate tax provisions, Mr. Justice Cardozo made a comment which definitely rejects the implications Judge Swan sought to attribute to his statement. Referring to the so-called estate tax credits on account of gift taxes paid in respect of previously transferred property, Justice Cardozo said (p. 286):

> "What is paid upon the one is in certain circumstances a credit to be applied in reduction of what will be due upon the other."

These credit provisions constitute an affirmative declaration by Congress of an intention immediately to impose gift taxes on *inter vivos* transfers of prop-

erty, even though the property so transferred may be subject to the estate tax on the grantor's death. Take, for example, the case of a gift made in contemplation of death. The property must be included in the gross estate under the specific language of Section 302(c) of the Estate Tax Title. Yet clearly the property is subject to the gift tax at the time of the *inter vivos* transfer. Realizing that such situations would arise, Congress made provisions for a system of estate tax credits on account of gift taxes paid in respect of previously transferred property which nevertheless was made part of the gross estate for estate tax purposes.† Mr. Justice Cardozo's reference to and recognition of these gift tax credits indicate that he had in mind no such idea as Judge Swan attributed to his remarks.

There is nothing, we submit, in the opinion of this Court in the *Guggenheim* case which justifies Judge Swan's reasoning that because a transfer in trust subject at death to a limited power to alter is part of the gross estate for estate tax purposes, the tax on gifts *inter vivos* should be delayed so long as such a power remains outstanding. On the contrary, the very holding in the *Guggenheim* case negatives the possibility of any such contention. Adopting the premise that in the case of a transfer in trust only one gift tax attaches, the *Guggenheim* case squarely holds that the taxable transfer occurs on the surrender of the power of revocation, that is, when the property is "put beyond recall". If this is so, it necessarily follows that on the occurrence of that

† Section 322 of the 1924 Act (continued in subsequent Acts) expressly provided that where a gift tax is imposed upon "any gift" and thereafter "upon the death of the donor the amount thereof [*i. e.*, of the gift] is required by any provision of Part I of this Title to be included in the gross estate", the amount of the gift tax shall be allowed as a credit against the estate tax.

event, the power to lay a gift tax is exhausted and the later surrender of a limited power to modify will not support a tax.

The Porter Case.

The *Porter* case was decided within two months after the *Guggenheim* case. The *Porter* case was an estate tax case involving the application of Section 302(d), added to the estate tax law in the Revenue Act of 1924. Porter created a trust in 1918, reserving the power "to alter or modify", but expressly excepting "any change in favor of himself or his estate". Porter died in 1926 after the enactment of Section 302(d). It was held that the corpus of the trust was includible within the gross estate on account of the existence at death of the reserved power.

"The power", said Mr. Justice Butler, who wrote for the Court, "did not amount to an estate or interest in the property." Having thus announced this premise, he proceeded to set forth with great care the structure of the estate tax provisions. Section 302, defining the gross estate, requires the inclusion of seven separate categories, namely, (a) any interest in property of the decedent at the time of his death; (b) any interest of the surviving spouse; (c) any interest of which the decedent has made a transfer in contemplation of or intended to take effect in possession or enjoyment at death; (d) any interest of which the decedent has at any time made a transfer "where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke"; (e) any interest held as a joint tenant or as a tenant by the entirety; (f) any interest in property passing under

a general power of appointment by will or by deed; and (g) the amount of life insurance receivable.

The petitioners argued, said Mr. Justice Butler, that (a) was a limitation upon (d), and since Porter had divested himself of all interest in the property prior to his death, it did not fall within the gross estate. Rejecting this argument, the Learned Justice said (p. 442):

> "Subdivision (a) does not in any way refer to or purport to modify (d) and * * * it cannot be said that, if it stood alone, (a) would extend to the transfers brought into the gross estate by (d)."†

After stating that "Congress has progressively expanded the bases for such taxation", Mr. Justice Butler then pointed out "that (d) is not a mere specification of something covered by (a) but that it covers something not included therein", adding (p. 443)—

> "The net estate upon the transfer of which the tax is imposed, is not limited to property that passes from decedent at death. Subdivision (d) requires to be included in the calculation all property previously transferred by decedent, the enjoyment of which remains at the time of his death subject to any change by the exertion of a power by himself alone or in conjunction with another."

The petitioners argued that since Porter was "without power to revoke the transfers or modify the trusts in favor of himself or his estate", the property was not covered by subdivision (d). But Mr. Justice Butler pointed out that the three words descriptive of the powers were used disjunctively, and

† This Court had already held that an *inter vivos* transfer in trust subject to a power of revocation was includible in the gross estate within subdivision (c). See Footnote, p. 34, *supra*.

hence the reserved power to alter existing at death was within the language of the Section, adding (p. 443)—

> "So far as concerns the tax here involved, there is no difference in principle between a transfer subject to such changes and one that is revocable. The transfers under consideration are undoubtedly covered by subdivision (d)."

In view of the use which Judge Swan made of this comment in the course of the majority opinion in the *Hesslein* case, it should be noted that the significant feature is the qualifying phrase "So far as concerns the tax here involved", namely, the estate tax. As so qualified, the statement is eminently sound, and as so qualified it is entirely inapplicable to the Gift Tax Act, which does not contain anything similar to subdivision (d).

The petitioners argued that to impose an estate tax would be to tax *inter vivos* gifts "that were fully consummated prior to the enactment of subdivision (d)." Not denying this, Mr. Justice Butler answered that such a contention failed to take into consideration the existence of "the power [to alter] the donor reserved unto himself alone", adding that the decedent's death "was, in respect of title to the property in question, the source of valuable assurance passing from the dead to the living", and concluded by saying (p. 444):

> "Thus was reached what it [Congress] reasonably might deem a substitute for testamentary disposition."

That is to say, a limited power to alter is not an "interest in the property", and accordingly it does not fall within subdivision (a). But subdivision (d)

goes beyond (a) and specifically requires the inclusion of previously transferred property still subject to such a power at death. The death of a grantor retaining such a power is the source of valuable assurance passing from the dead to the living, and Congress might require the inclusion of such property since what it reached might reasonably be deemed "a substitute for testamentary disposition."

Mr. Justice Butler's analysis of the estate tax provisions really controls, we submit, the question here presented. Section 319 of the Gift Tax Act imposes a tax on "the transfer * * * by gift * * * of any property." This in legal import is the counterpart of (a) in the Estate Tax Act. Both are confined to the transfer of a present interest in property. Neither section, either expressly or by implication, purports to lay a tax on the surrender of a limited power to alter. But (a) in the Estate Tax Act does not stand alone. There is subdivision (d), which specifically broadens the incidence of the estate tax to include property subject to such a power. The Gift Tax Act does not contain any counterpart of (d), although Congress had before it the structure of the estate tax provisions when it framed the gift tax. It would seem to follow as a matter of simple logic that in the absence in the Gift Tax Act of any provisions covering reserved powers and their surrender, the gift tax was laid and was intended to be laid on the present "transfer" of the property, and not delayed on account of the existence of a retained power to alter.

In summary, we submit that the *Guggenheim* and *Porter* cases establish the following principles: (1) under the Gift Tax Act only one tax in respect of a transfer in trust is levied; (2) where a power of revocation is terminated there is a "transfer" of the property and the gift tax attaches; (3) by the necessity of

exclusion, a gift tax does not attach where in a subsequent period a reserved power of modification is surrendered; (4) under the Estate Tax Act, subdivision (a) is not broad enough, standing alone, to include property covered by a limited power to alter; in order to include this in the gross estate subdivision (d) is necessary; (5) under the Gift Tax Act the only incidence of tax is the "transfer" of property, which is the counterpart of (a) in the Estate Tax Act; the Gift Tax Act has no counterpart of (d), and hence the incidence of the Gift Tax Act does not extend to the surrender of a limited power of alteration.

This Court only recently has considered the character of a grantor's interest in a trust subject to a reserved power of revocation, as it bears upon a state's jurisdiction to tax. *Curry* v. *McCanless, Commissioner*, No. 339, October Term, 1938, decided May 29, 1939; *Graves, et al., Commissioners* v. *Elliott*, No. 372, October Term, 1938, decided May 29, 1939. In the *Elliott* case, this Court said that "The relinquishment at death, in consequence of the non-exercise in life, of a power to revoke a trust created by a decedent" is a proper subject of state taxation at the domicile of the grantor. This is a clear recognition of the principle that the termination by death of a retained power of revocation constitutes a "transfer" of the property subject to the power. That being the case, it must be equally true that where such a power is terminated by a surrender *inter vivos*, there occurs the "transfer" of the property, for at that point the "equivalent of ownership" no longer exists. But in the case of a limited and non-beneficial power to alter, the power is not the "equivalent of ownership", and, as this Court said in the *Porter* case, it does not constitute an "interest" in the property. At most, the termination of the power on death is

only "a substitute for testamentary disposition" sufficient to support an estate tax. Accordingly, the surrender *inter vivos* of such a limited power to alter cannot amount to a "transfer * * * by gift" of the property subject to the power, since the "transfer" has already occurred when the beneficial power to retake was previously surrendered.

While both are transfer taxes, the estate tax and the gift tax are, in fact, taxes of a very different character. The estate tax is the last tax which the Government may impose upon a citizen. The history of the estate tax makes it abundantly clear that Congress has continuously enlarged the scope of the Act to include an ever-increasing field, of which perhaps Section 302(d) is the most extreme instance. Being the final exaction, this Court has gone far in upholding the estate tax in its broad scope. *Helvering* v. *City Bank Co.*, 296 U. S. 85 (1935); *Porter* v. *Commissioner, supra.*

But the gift tax, unlike the estate tax, is not a final catch-all. It is a simple tax upon the *inter vivos* "transfer * * * by gift * * * of any property". It is an intermediate tax and not a final tax in the sense that it is imposed immediately upon any *inter vivos* transfer, whenever occurring, as distinguished from the final tax imposed at death. While enacted in part to prevent estate tax avoidance, the gift tax is a wholly separate tax and should be so interpreted.

In spite of Mr. Justice Butler's clear analysis of the structure of the estate tax in the *Porter* case, the absence of any counterpart of subdivision (d) in the Gift Tax Act, the difference in character between a power of revocation and a non-beneficial power to alter, and the lack of similarity between the estate tax and the gift tax, Judge Swan in the *Hesslein* case brushed aside all these considerations, treated the

two kinds of powers as of equal dignity and said that since the primary purpose of the gift tax is to supplement the estate tax "it is reasonable to construe the former as excluding gifts so incomplete by reason of powers reserved to the donor, as to be expressly made subject by the latter to the estate tax".

This, we submit, is a fundamental misconstruction not only of the two statutes but of the decisions of this Court in the *Guggenheim* case and the *Porter* case. It is tantamount to saying that Congress intended to postpone any gift tax upon an *inter vivos* transfer in trust so long as the property which is the subject matter of the trust is includible within the gross estate should death intervene. The language which Congress used in imposing the gift tax does not justify any such conclusion; an analysis of the Estate Tax Act, when compared with the language imposing the gift tax, does not justify such a conclusion; the existence of the estate tax credit provisions in respect of previously paid gift taxes belies such a conclusion; and, we respectfully submit, it is definitely contrary to the reasoning of this Court in the *Guggenheim* and *Porter* cases.

IV.

The reasoning advanced in the majority opinion in the *Hesslein* case, adopted by the Court below, is fallacious.

A reading of Judge Swan's opinion in the *Hesslein* case leaves one somewhat bewildered. At the outset of his opinion, he declares that "where the settlor reserves the power to revest title in himself" no gift tax is imposed, and adds that "in such a case the gift of the corpus occurs when the power of revocation is terminated", citing Section 501(c) of the Revenue Act of 1932 and the decision of this Court in the *Guggenheim* case. Then he says that the power involved in the *Hesslein* case was not as absolute as that considered in the *Guggenheim* case, but asserts that it "is nevertheless broad enough" to enable the donor "to make a complete revision of all he has done", save only that "the alteration must not revest any interest in himself or his estate". Quoting from Mr. Justice Butler's opinion in the *Porter* case, he argues that for estate tax purposes there is no difference in treatment between a power to revoke and a limited power to alter, and concludes that "this is equally true so far as concerns the gift tax".

In so reasoning, Judge Swan utterly failed to differentiate between the character of a power to revoke and the character of a non-beneficial power to alter; and in so far as his reasoning is bottomed on the treatment of powers for estate tax purposes, it is fundamentally fallacious.

Next Judge Swan argues that when there exists a power to change beneficiaries "nothing has been done to give assurance that any part of the principal will ever be received by the named donees", and as

"the donee of any gift" is secondarily liable for the tax, it "seems unlikely that Congress would intend to impose personal liability upon a donee who might thereafter be deprived of all interest in the property at the will of the so-called donor", using, for example, the appointment of the corpus to a charity, and adding that a gift "demands a donee as well as a donor", and is "incomplete" until "the beneficiaries are determined".

Here Judge Swan confuses the trust estate as such and those who are beneficially interested in the enjoyment of the property. In a trust of this character, the individual beneficiaries are not "the donee" in the sense that they are the persons presently made liable for the tax; it is the trustee as the representative of all interests, present and future, and all persons, determined and undetermined, which is the donee in this sense. Under the 1924 Act, a ten year statutory lien attached to the donated property, and in the case of a trust the "trustee" as custodian of the property subject to the lien was liable for the tax in the event the donor failed to pay. See Revenue Act of 1924, Section 315 (a) and (b).† In the 1932 Act, the secondary liability was imposed broadly on "the donee", with a ten year lien on the property. This change in the statute did not, we submit, shift the liability from the trust estate and impose a personal liability on the beneficiaries as such, for surely it was not the intention of Congress to make one of a number of beneficiaries individually liable for the entire tax, regardless of the extent of his interest in the trust estate.

† The word "beneficiary" in Section 315(b) obviously refers and refers only to the word as used in (b)(2), namely, a beneficiary under an insurance contract, and does not include the beneficiary of a trust.

But the argument is quite erroneous on account of a fundamental fallacy. Judge Swan overlooks the point that in the case of a trust the need of a fixed donee capable of taking is quite separate from the possible shifting of the beneficial enjoyment, whether such shifting may be pursuant to a power in the settlor or pursuant to contingencies provided for in the trust deed. As he himself points out, there cannot be a valid gift, whether direct or in trust, without an identifiable and fixed donee. But trusts of the character of those here involved are valid trusts and do not fail for the lack of a donee, namely, the trustee or the trust estate as a whole; they are not incomplete because subject to a reserved power to change beneficiaries or to appoint to a charity.

In the case of a *revocable* trust, such as this Court considered in the *Guggenheim* case, obviously there is no permanent donee so long as the power of revocation remains outstanding. But where a trust has become *irrevocable* by the settlor's surrender of all power to revest in himself income or corpus, the trust thereupon is final and permanent and a final and permanent donee exists. By the surrender of such a power the grantor is deprived for all time of the property, and the complete and full beneficial enjoyment of such property is assured for all time in others than the grantor. In such a case, there is no burden in requiring the payment of the tax upon the surrender of the power to revest. It matters not whether a charity is ultimately substituted as the beneficiary, for this occurs by the donor's own act and neither he nor the trust estate can complain. In the case of a charity, the exaction of a tax at the point when the power to revest is surrendered consti-

tutes no greater burden than where there is an absolute transfer in trust, with a charity named as a contingent beneficiary, and the contingency later occurs. In such a case no one would complain that the exaction of the tax on the creation of the trust was improper or unsound.

Next Judge Swan argues that in any event there is "at least uncertainty" whether a trust which leaves the beneficiaries so indeterminate is the kind of gift which the statute was meant to tax. But if the imposition of the gift tax must await the resolution of contingencies, the tax would often be postponed indefinitely, even where there are no reserved powers. There is hardly a trust which does not contain provisions for the contingent shifting of the beneficial interests, and trusts are of everyday occurrence where, with or without the accumulation of income during minority, on the death of a named life tenant there are contingent gifts over of income and principal, which may not be determinable for many years, and often with a contingent gift over to charity. Surely Congress could not have intended to withhold the imposition of the gift tax in the case of such trusts until all the contingencies were resolved and the beneficial interests finally fixed. Yet this would follow from Judge Swan's reasoning. Judge Hand in his dissenting opinion laid emphasis upon this point, saying (p. 957):

> "It seems to me to make no difference that the settlor in the present case can shift these interests according to his future will instead of leaving them to be determined by contingencies provided for in the deed of trust."

Next, Judge Swan argues that the gift tax and the estate tax "must be construed in conjunction", citing

Mr. Justice Cardozo's comment in the *Guggenheim* case that the two statutes are in *pari materia,* and adding that "it is reasonable" to construe the gift tax as excluding transfers expressly made subject to the estate tax. As we have seen (p. 46, *supra*), Mr. Justice Cardozo in making this comment had no such idea in mind. He likened the two statutes on the score only that in their application form should not be exalted over substance.

Finally, Judge Swan's treatment of the Treasury Regulations is difficult to explain. The Regulation before him was Article 3 of Regulations 79 (1933 Edition). He conceded that this Article "has construed the statute as imposing a gift tax on such a transaction as the one involved in the case at bar." Then he added, "These regulations, however, are of recent adoption and have not the sanction which would result from a subsequent reenactment of the statute." As we have pointed out on pages 23-4, *supra,* Judge Swan must have been wholly unaware that the rule which he so casually brushed aside had been embodied in the formal Regulations of the Commissioner ever since the enactment of the Gift Tax Act of 1924, and that the 1932 Regulations were an adoption and continuation of the same rule. Had he realized this permanency and uniformity of rule, his comment would have been wholly unwarranted.

By way of comparison with Judge Swan's reasoning, we respectfully commend the cogent and persuasive reasoning of Judge Augustus N. Hand in his dissenting opinion. "In the case at bar", said Judge Hand, "the settlor parted with all beneficial interest in the corpus when he created the trust and under his reserved power could only make appointments by will in certain conditions or modify the trusts in favor of new beneficiaries without revesting anything

in himself." Citing the *Guggenheim* case, he added that the settlor "made no gift until he renounced his right to retake possession of the res."

After commenting on the fact that there seems to be no distinction between a case where the beneficial interests are shifted according to the will of the settlor or according to the contingencies provided for in the trust deed, Judge Hand advanced a most convincing argument. He said that Section 501(b) taxes generally all transfers in trust; that subdivision (c) excludes from taxation "property transferred in trust where the settlor had reserved a power to revest title in himself and had not relinquished the power." Accordingly, says Judge Hand, the sweeping language of (b) requires the imposition of a gift tax except in the narrow case excluded, and so the transfer subject to the gift tax occurred on the creation of the trust.

Judge Hand was considering the 1932 Act and not the 1924 Act. Nevertheless, the same considerations apply here, for as this Court said in the *Guggenheim* case, "We think the regulation [the 1924 regulation], and the later statute continuing it, are declaratory of the law which Congress meant to establish in 1924."

Conclusion.

As the record discloses, the Treasury considered this case with the utmost care. The various considerations for and against the rule for which we contend were attentively received and earnestly considered, and in the end the Treasury upheld the rule of its Regulations, and for good reason—it was sound in principle, it was simple and easily applied, it carried out one of the main purposes of Congress in en-

acting the Gift Tax Act, and it preserved the Government revenues and prevented widespread tax avoidance.

It is respectfully submitted that the decision of the Circuit Court of Appeals for the Third Circuit should be reversed, and the case remanded, with a direction to enter a judgment of no deficiency.

Respectfully submitted,

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Dated, September 15, 1939.

APPENDIX.

The Gift Tax Statutes.

Section 319 of the Revenue Act of 1924:

"For the calendar year 1924 and each calendar year thereafter, a tax equal to the sum of the following is hereby imposed upon the transfer by a resident by gift during such calendar year of any property wherever situated, whether made directly or indirectly, and upon the transfer by a nonresident by gift during such calendar year of any property situated within the United States, whether made directly or indirectly: * * *"

Section 501 of the Revenue Act of 1932:

"(a) For the calendar year 1932 and each calendar year thereafter a tax, computed as provided in section 502, shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift.

(b) The tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible; but, in the case of a non-resident not a citizen of the United States, shall apply to a transfer only if the property is situated within the United States. The tax shall not apply to a transfer made on or before the date of the enactment of this Act.

(c) The tax shall not apply to a transfer of property in trust where the power to revest in the donor title to such property is vested in the donor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such property or the income therefrom, but the relinquishment or termination

of such power (other than by the donor's death) shall be considered to be a transfer by the donor by gift of the property subject to such power, and any payment of the income therefrom to a beneficiary other than the donor shall be considered to be a transfer by the donor of such income by gift."

[Subdivision (c) of Section 501 was later repealed by Section 511 of the Revenue Act of 1934. See Brief, p. 23, *supra.*]

The Gift Tax Regulations.

Article 1, Regulations 67 (1924 edition):

"The creation of a trust, where the grantor retains the power to revest in himself title to the corpus of the trust, does not constitute a gift subject to tax, but the annual income of the trust which is paid over to the beneficiaries shall be treated as a taxable gift for the year in which so paid. Where the power retained by the grantor to revest in himself title to the corpus is not exercised a taxable transfer will be treated as taking place in the year in which such power is terminated."

Article 3, Regulations 79 (1933 edition):

"Transfers in trust.—Where property is transferred in trust without an adequate and full consideration in money or money's worth and without the reservation of the power to revest in the donor title to such property, the transfer is a gift, but, where the donor reserves such power, the transfer does not constitute a gift within the meaning of the statute. The relinquishment or termination, without an adequate and full consideration in money or money's worth, of the power to revest in the donor title to property

transferred in trust, is a gift of such property at the time of the relinquishment or termination of the power, except where the power is terminated by the donor's death."

Income and Estate Tax Provisions Covering Reserved Powers.

Section 219 (g) of the Income Tax Act of 1924:

"Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor."

Section 302 of the Estate Tax Act of 1924:

"The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property * * *—

(a) To the extent of the interest therein of the decedent at the time of his death * * *

* * * * * * *

(d) To the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for a fair consideration in money or money's worth; * * *"